Value Added Tax (VAT) - implementation issues in Albania

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Abstract Value Added Tax (VAT) today is the main tax in most countries, including Albania, as it represents the largest share in budget revenues.
The tax system applied to VAT is similar to the regressive system, where with increasing income the tax burden decreases. So being a consumption tax low-income households spend a large portion of their income on consumption as opposed to high-income households, so they bear a greater burden compared to the income they benefit. An increase of the VAT rate inevitably affects the increase in: inflation, unemployment, interest rate, so people in general will become poorer.
The government should be careful in the fiscal policy that it implements so that the increase of budget revenues to can be achieved not through the increase of the tax burden, but through the expansion of the tax base and the implementation of VAT rates in an escalated manner, in order to facilitate tax burden for lower income families.
This study focuses on the problems encountered in the implementation of VAT in Albania and its impact on the economy. For the purposes of the study, the methodology used consists of the use of quantitative and qualitative methods, quantitative methods were used by analyzing primary data collected by the author, as well as qualitative methods by analyzing secondary data, collected from publications of well-known authors in this field and official institutions.
Keywords: Value Added Tax (VAT); Fiscal system, Tax rate; Fiscal policy.

1 Introduction

Value added tax/VAT, considered as the tax that collects the most government revenue in countries that have made it part of their fiscal package, has been studied on its interaction with multiple components. Different authors have reached different conclusions about the relationship between VAT and GDP, but most argue that there is a positive relationship between these two variables.

The dilemma of the tax system, whether VAT should be applied at a single rate in a given country, or should be applied at multiple rates has sparked numerous discussions by politicians, researchers and analysts giving their opinions on the best performance of this tax. In addition to discussing whether there should be a VAT rate or multiple rates, another discussion is whether there should be a zero VAT rate? Various authors (Jansen & Calitz, 2015: 6) argue that removing the zero VAT rate would reduce distortions in the economy and could allow us to focus on those measures (such as social goals) where capital gains are higher. Despite the arguments given, different states have pursued and implemented different policies.

Also, an important issue of debate has been that governments often find it difficult to choose the optimal level of turnover threshold in relation to VAT, in which firms are required to register, a choice which is important for the administration of VAT. Some researchers argue that one advantage of raising the VAT threshold is that it reduces administrative costs, but attitudes towards VAT exemptions from the first application of VAT until today have become part of the fiscal package in many places. In some countries VAT regimes are characterized by a consumption tax base with several tax rates, multiple exemptions and the application of the refund method. Various researchers argue that the design of VAT should minimize as much as possible the number of exemptions for an efficient system.

There are various arguments for implementing VAT in a tax system. But most scholars and analysts argue that a broad and uniform value-added tax promotes economic neutrality and effectiveness, as opposed to other taxes such as personal income tax and corporate income tax. Broad-based VAT and a rate applied so far in Albania has made that there is not much interference or distortion of individuals' decisions to consume or save, to favor the purchase of a product more than a another or for businesses to produce a certain product or another. On the other hand, income tax tends to distort these decisions. Because personal income tax in recent years in Albania has been implemented at progressive rates, increasing with increasing income level - as a result it may discourage some individuals from working. Withholding tax can tax investment income, thus reducing the savings.

Countries that have implemented VAT in their tax systems are the countries with the highest income stability. The implementation of VAT, for a long period in the tax system of Albania, has influenced the increase of tax revenues and the orientation of Albania towards the model of taxation through VAT, keeping the inflation rate under control, formalization of the economy positively affects the tax revenue stability ratio.

The purpose of the study is to analyze VAT, its impact on tax revenues and problems related to VAT administration in Albania.

The main objectives of this study are:

- Identification and analysis of VAT and factors affecting the realization of tax revenues.
- Treatment of the legal and regulatory framework on the basis of which VAT is administered in Albania.
- Analysis of VAT issues in Albania.

Study methodology. To fulfill the purpose of the study and to reach accurate conclusions, the research methodology will include both data sources, primary data collected by the author through questionnaires and interviews, as well as secondary data collected from publications well-known authors in this field and official institutions.

The research question is: What are the factors that affect the level of VAT revenues in Albania?

2 Literature Overview

The authors Keen and Lockwood (2010) argued that: “VAT is more likely to increase tax revenues in countries with relatively high levels of GDP per capita and in countries with 'open economies' for two reasons: First, higher-income countries are more likely to cope with administrative and VAT compliance requirements; Second, VAT revenues account for a large share of total revenues in most developing countries.”

While the authors Auriol and Warlters (2011) who conducted the study to estimate the costs of managing public funds for five tax instruments in 36 African countries, concluded that VAT was the tax instrument with the lowest cost.

The study by Ebeke and Ehrhart (2012) on 103 developing countries observed during the period 1980-2008 confirms that the average level of tax revenue volatility in countries without VAT is significantly higher than in countries with VAT.

Author Anna Moździerz (2017) in her paper points out that: “Taxes give fiscal authorities the means to influence prices. Reconstructing the tax system towards an equal distribution of taxes between direct and indirect taxes would help reduce inflationary pressures”. The author links the function of the tax system to the impact of macroeconomic indicators, such as inflation.

While the author G, Carlotta (2015) in her paper states that: “Designing a tax system and modeling tax reforms are always the result of a compromise between the revenue objectives and distribution issues faced by policymakers. The balance between these two objectives determines the scope of tax intervention and requires adequate methods to assess the overall effectiveness of the preferred tax system in achieving its goals”.

An important feature of the tax system in many countries is the dominance of consumption taxes or indirect taxes in general. To support this theory, the authors Gordon and Li (2009) point out that consumption taxes make up more than half of total government revenue in poor countries.

The authors Yalama & Gumus (2013), state that high tax rates and the tax burden increase tax evasion.

In their work Alberts Auziņš, Alexeys Nipers & Wolfs Kozlinskis (2008) have concluded that: "VAT has a very special impact on market equilibrium. The VAT mechanism that affects market equilibrium differs from the impact of direct and indirect taxes. This comes as a result of the impact of VAT on the market equilibrium, in the case of consumers, affecting the marginal income of the firm (seller) without affecting the demand itself.

Moreover, Radeke, Petersen & Giucci (2015) emphasize that: "An efficient tax administration is a prerequisite for the success of the introduction of VAT and the prevention of fraudulent activity".

In developing countries, tax administration and poor enforcement are often cited as major obstacles to VAT approval, given that the latter requires more information and specific skills to be effectively administered (Boadway & Sato, 2008).

Likewise, according to the author Macharia W. B., (2014), "The level of management commitment has been proven to influence the adoption of VAT. Given that the customs collects a significant part of VAT revenues, it is a priority to work effectively in these institutions to perform the relevant tasks. The author continues the argument that: "staff is the most critical component of human resources in the VAT department, which is entrusted with the responsibility of ensuring tax compliance. Therefore, according to the author, staff and other stakeholders need to be equipped with updated skills to increase VAT compliance through social media. The paper also concluded that the training of staff has an impact on VAT approval. Information technology is nowadays has become an important tool for the efficiency of tax administrations".

Shojaee, T. (2016) confirmed the hypothesis that "information technology affects the efficiency of the tax system with a level of 95% reliability. The author adds that the use of information technology helps auditors and tax experts in analysis and decision-making and creates more efficient management systems in organizations".

The authors De la Feria & Krever (2012) in their study conclude that "historical factors that led to multiple levels and multiple exceptions to traditional European VAT were not present in most non-EU jurisdictions and adopters of a the modern VAT model were able to avoid these features of traditional VAT, for the most part by adopting single rates and substantially limiting the number of exemptions. The authors argue that more limited exemptions have imposed changes in economic and administrative costs, however, prompting some of the modern VAT jurisdictions to explore more modern alternatives, particularly in the area of financial services, but also in relation to supplies from small and medium corporates, as well as registration thresholds".

For the author Sørensen, (2017) "many financial services are exempt from value added tax, although it may be required, there are technical difficulties in applying VAT for these services".

From the different approaches of the above authors it is concluded that the problems related to the implementation of VAT tax rates, the determination of the taxable base and exemptions, as well as the refund process are some of the main issues for which policy makers should be careful in following-up fiscal policies and the decision-making of this area.

3 Some problems of VAT implementation in Albania

In Albania, as in many other countries in the region, the indirect tax base still remains narrow, this requires a review of the model of adaptation to the economic and social environment in order to expand this base. The share of direct and indirect taxes in the tax burden has remained almost unchanged for many years, where indirect taxes have occupied the largest share in the structure of tax revenues, this still shows a tax burden borne by the Albanian consumer, and not by the real economy. On the other hand, this reflects the need to modify fiscal policy to shift the burden from consumption to capital, as it should be wealthy individuals and large businesses who should bear the brunt of the burden in this regard.

In the state budget revenues, VAT is the main tax that occupies about 35% of total revenues and with the new legislation adopted, in general the structure of this tax is harmonized with that of the member states of the European Union, so will not undergo fundamental changes due to Albania's integration into the EU.

For a better administration and increase the in efficiency of indirect taxes, especially VAT, which is the main source of tax revenue, some important issues that need to be discussed for Albania and should be in the attention of policymakers are:

Firstly, the VAT threshold. The changes made by the government in the fiscal packages of recent years by reducing the VAT registration limit of businesses that achieve a total annual turnover influenced the expansion of the base of this tax by increasing the number of businesses that declare and pay this tax, thus leading to a greater formalization of the economy. But, an unclear fiscal policy was pursued during 2020 with the aim of benefiting businesses by excluding from VAT businesses with annual turnover over ALL 10 million (considered small), these changes that were approved with the last fiscal package can be affect the opposite arm, but the impact of this reform undertaken will be measured in the following tax periods.

Although various researchers argue for the existence of a limit that has little impact on business if the goods and services were to be sold to registered tax-administered businesses, in practice setting a turnover limit distorts the decision-making of many businesses. Therefore, the optimal value of the turnover limit can be called the limit where the tax is applied on all sales and not only on the turnover limit set by law.

Albania's practice shows that businesses try to stay either slightly below the turnover limit, or in parallel with it, hiding the declared income that they usually realize through the shortcomings of small business that does not use sales / purchase documentation and relevant VAT tax invoices, as well as by the inefficient administration of fiscal authorities.

This type of exemption and any other exemption that has been made in recent years has created opportunities for tax evasion and tax evasion, so the fiscal policy that the government should pursue should be very careful in cases where it makes decisions on exemptions, as they can encourage an unstable business environment with economic consequences.

Secondly, the establishment of escalated VAT rates. In these times, it is found that only Bosnia-Herzegovina and Albania generally apply a standard average VAT rate, while other Western Balkan countries apply reduced VAT rates.

One problem with VAT is its disproportionate impact on limited and low-income people, as long as the tax is the same for both high-income and low-income people, then it affects the low-income individual. The application in Albania of the standard VAT rate on basic consumption products affects the reduction of the real income of individuals with limited and low incomes. So, VAT will have a negative impact by discouraging consumption, at a time when Albania's economy is tending to increase consumption, any decline in spending will reduce consumption, will increase the level of unemployment, hurting the country's economic growth.

In this period when most of the fiscal burden in Albania is still borne by individuals with limited and low incomes, a reform of the tax system is needed to rebalance the tax burden with the aim of shifting the fiscal burden to capital taxes.

Therefore, even for Albania, the establishment of escalated VAT rates accompanied by an increase in administrative capacity would be an action that would lead to increased effectiveness of this tax.

Third, the determination of cases of VAT exemptions. Excluded supplies deduct VAT on the value added of the respective supply. In general, fiscal policies, simple tax administration, tax justice and economic tax neutrality are arguments that support the minimal use of exemptions. Various economic, political, social and tax administration situations in Albania and other countries have influenced the determination of VAT exemptions. The case of exemption of entities with low turnover was treated above, which is a kind of general exemption of all supplies of goods and services from entities that have a turnover lower than the limit set for VAT registration. In many cases it is assumed that "exemptions" result in a reduction of the VAT tax burden on supplies. To avoid distortions caused by the failure to deduct VAT on paid purchases, a good policy could be pursued not to exclude the types of supplies made for genuine business activities.

In order to administer VAT efficiently, it is necessary not only to estimate the VAT gap, but also to fill the tax gap by expanding the base of this tax.

Finally, since VAT is the only tax used by the government, not only to collect a significant portion of the money in the budget, but also to pay a large portion of it back in the form of a refund, where each VAT invoice constitutes a possible claim from public funds. Falsification of such claims is probably the most common form of VAT fraud in Albania, this makes important from the point of view of the administration of this tax, more detailed knowledge on future claims for reimbursement.

Fiscal treatment of refunds is defined in the law on VAT and tax procedures to the extent of legal conditions for refund, but refund procedures and entities that have priority for refund are treated in the instruction, as well as the refund of exporters and financial agreements are treated in guidance, therefore it is necessary to design a risk management strategy.

Some other problems in the application of VAT in Albania are: shortcomings in legislation, registration and deregistration of taxpayers, construction and minimum fiscal cost, tax assessment and control, etc.

Conclusions and Recommendations

The government in the fiscal policy to be pursued should be careful in setting an optimal VAT threshold that helps in the good administration of this tax, leads to the formalization of the economy, strengthens fiscal education by increasing billing and maintaining fiscal documentation, as well as correctly addresses the appropriate segments of taxpayers.

The application of scaled VAT will improve its regressive effect on the services and goods provided and will increase the effectiveness of this tax.

If VAT is not fully administered and with the inclusion of any value added of the economy, it will continue to undermine neutrality by weighing on the price of goods and services taxed with this tax.

Exceptions of economic sectors and activities specified in the activities defined in the VAT law, exemptions with special laws and international investment agreements, reduction of the tax rate below the standard VAT rate, have an important influence in the creation of tax gap.

Reimbursement is a simple and widespread mechanism that affects the functioning of the VAT scheme, so it is necessary to design and implement a risk management strategy for reimbursements to be made in future periods.

Efforts to increase fiscal administration capacity in order to expand the tax base is essential in creating a sustainable business environment and economic growth of the country.

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